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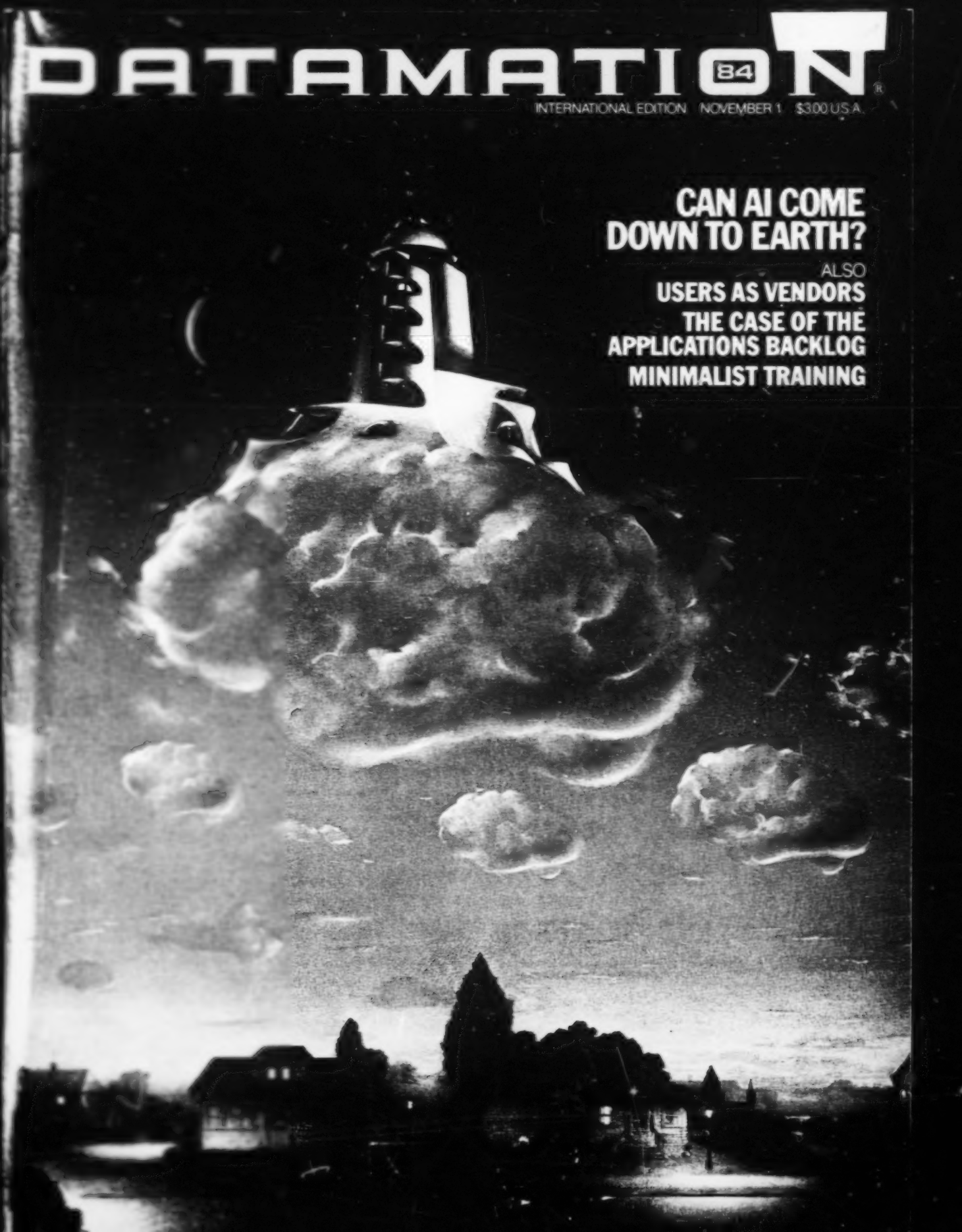

# CAN AI COME DOWN TO EARTH?

ALSO

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**THE CASE OF THE APPLICATIONS BACKLOG**

**MINIMALIST TRAINING**

# DATAMATION

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COVER ILLUSTRATION BY RICHARD BOBER

**The high dollar has given headaches to Uncle Sam's dp vendors overseas.**

# DEALING WITH DOLLARS

**by John Lamb and Paul Tate**

While the soaring dollar may be a feather in President Reagan's cap, it's clipping the commercial wings of American data processing companies doing business abroad.

Each time the dollar shoots up another point, Yankee profits from overseas operations take a nosedive. This inexorable process, which has steadily been eroding earnings for the last five years, is forcing U.S. firms to find new ways of operating on foreign shores.

One U.S. company that's been hit hard by the dollar surge is Sperry. Back in 1982 the company blamed the strong dollar for slashing $140 million off its annual sales. Since then, revenues from its European and African operations have plummeted almost 25%, going from $1.3 billion in 1982 to just under $1 billion in fiscal 1984.

A glance at the currency exchange table tells why Sperry, along with other U.S. companies, has been caught in the dollar trap. By mid-August, the dollar was trading at an 11-year high against the deutschmark and at record levels against the pound sterling and French franc. Since 1980 the dollar has skyrocketed 40% against the major currencies.

The strong dollar has had a double-whammy effect on American dp firms. First of all, it makes their U.S.-manufactured products more expensive in overseas markets. As one European industry observer quipped, U.S. products are now "overpriced, as well as oversold and over here." Secondly, the soaring dollar significantly cuts into the profits remitted to the U.S. parent.

IBM, the number one company in European dp, makes this point with predictable sobriety in its latest annual report. Noting the "adverse impact" of the strong dollar on overseas profits, Big Blue explains that "as the dollar strengthens, net assets and net earnings recorded in local currencies are translated into fewer U.S. dollars than they would have been at the previous year's rates."

To get some of those bucks, IBM, along with other U.S. multinationals, has increased prices, particularly on the software side. This move has caused chagrin among European users, who have bitterly complained through their local user groups. Hardware products have escaped the price hikes, mainly because IBM manufactures much of its product range in Europe. The company operates 15 plants in seven different countries, churning out wares that are worth around 90% of its total European sales.

Big Blue boasts a strong European presence. The company, which employs about 100,000 people in Europe, runs nine R&D facilities and five scientific centers. Last year the company invested $1.5 billion dollars in Europe, bought $1.8 billion worth of goods and services from local suppliers, and paid a cool $1.25 billion in local taxes.

IBM is also increasing its market share in Europe. The company's European sales in 1983 represented 42% of the total revenues earned by the top 25 dp companies in Europe (see "Crowning Europe's Dp Royalty," Aug. 1, p. 136-5). IBM Europe is nevertheless adding less to the corporate coffers as the years go by. In 1979, IBM Europe accounted for 40% of the company's total business, compared with the 27% it contributed in 1983. At fault is the currency slide, which has also clouded IBM Europe's profit picture.

FIG. 1

**THE U.S. TOP 10 IN EUROPE**

| Company | 1983 DP Revenues In Europe ($M) | 1983 Total Revenues Worldwide ($M) |
|---|---|---|
| IBM | 10,758 | 40,180 |
| Digital Equipment | 1,107 | 4,827 |
| Burroughs | 977 | 4,389 |
| Hewlett-Packard | 814 | 4,858 |
| Sperry | 705 | 4,745 |
| NCR | 683 | 3,731 |
| Control Data | 617 | 4,580 |
| Honeywell | 484 | 5,753 |
| Wang | 346 | 1,792 |
| Xerox (Rank Xerox) | 206 | 8,463 |

Source: DATAMATION European Top 25

## "From a bookkeeping point of view, it looks cheaper to operate in Europe."

"International operations are expected to return a contribution that will add to the dollar profits of the company," explains Robert McMicking, Digital Equipment Corp.'s business finance manager in the U.K. "But with the currency situation, two things happen: absolute profit goes down and marginal profit gets hit too."

With this sword of Damocles hanging over them, American companies have four options, according to McMicking. They can cut local spending, sell more products, increase the overseas content of those products, or raise prices.

### HIGHER PRICES NO PROBLEM

DEC has been upping prices in the U.K. every six months for the past three years. McMicking claims these price increases have had little impact on DEC's market share. "We have taken pricing action when others haven't," he says, "and it hasn't hurt us."

DEC has also begun investing heavily in European plant. It recently opened a $30 million chip facility in Scotland, and a mass storage production factory in West Germany. A new peripherals manufacturing facility in France will also be in operation soon. The mini maker has plowed still more capital into remote diagnosis and repair facilities—something it really needed, since until recently the company used to return machines to the U.S. for repair.

McMicking is candid about DEC's manufacturing efforts in Europe."Setting up manufacturing is difficult and I'm afraid it has been a question of too little, too late at Digital. But I am not sure how many people would have looked into their crystal balls three years ago and seen the pound drop in relation to the dollar from 1.9 to 1.28, where it was this summer."

Hardware companies like DEC are particularly vulnerable to the strong dollar syndrome, especially when they do little or no local manufacturing. Data General, which imports all its systems into Europe, is in that vulnerable category. Bill Cadogan, a European marketing manager for DG, puts a brave face on the problem. "We have adjusted our prices," he says, "but we have also totally redeveloped our product line with systems that have strong price/performance."

Data General customers faced price hikes in August, but Cadogan claims his company has been able to conceal higher margins because of the price-performance of the MV supermini range.

Data General also claims that the higher prices have not resulted in lower sales, though Cadogan admits there is a limit to customers' patience. He maintains that the British market is very buoyant. This buoyancy, coupled with "substantial increases in sales productivity," has helped the company maintain its market position in Europe.

At Memorex, international president Lars Turndal is not so sanguine. "We are losing market share every day, particularly to European companies," he says. "I am really suprised that anyone can tell you differently." Turndal, who oversees operations in 26 different countries, believes that many U.S. dp firms were caught unawares by the dollar dilemma.

"We saw what was coming early and began investing in local plant, increasing prices, and hedging on the foreign exchange markets," he says. In Latin America, for example, Turndal demanded payment in dollars, instead of local currencies.

"When you are a multinational there are several things you can do," Turndal explains. "You can buy forward currency—called hedging—and you can try to source more products outside the U.S. We do this particularly in Italy, Sweden, and Japan. Looking overseas for products is good in its own right: they don't know everything in the U.S."

Despite all their efforts, Memorex is still finding the going tough in Europe, especially in Great Britain, West Germany, and Switzerland. Turndal feels the problem is complicated by sudden swings in exchange rates. "Our biggest concern is whether the business we conclude today is going to be profitable in six to eight weeks' time when we deliver," he says. Memorex's oem customers are currently being offered dollar clauses in their contracts. If the dollar goes up before delivery, they pay a supplementary fee. If it goes down, they get a refund.

But Turndal must tread warily as he balances currency shifts with price increases. In addition to buying foreign ex-

FIG. 1

**EUROPEAN CURRENCY TABLE**

| | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---|---|---|---|---|
| German mark | 1.9590 | 2.2542 | 2.3786 | 2.7238 | 2.7842 |
| French franc | 4.5160 | 5.7480 | 6.2750 | 8.3475 | 8.5445 |
| Pound sterling | .4192 | .5241 | .6194 | .6894 | .7393 |

Source: Economist Intelligence Unit

### STRANGERS IN PARADISE

While the strong dollar may be giving U.S. companies a hard time in international markets, their employees with dollar-based salaries are having the time of their lives.

A report from The Conference Board in New York reveals that since 1981, costs for Americans working abroad have fallen in 18 of the 20 major cities around the world. The American in Paris, Copenhagen, or London can expect to buy more food, clothing, and medical care for his dollar.

In Copenhagen, for example, living costs, excluding housing, have dropped to an average of $26,102 a year from $31,993—the biggest improvement recorded by The Conference Board. In London, the story is the same. A $60,000-a-year executive on average spends $25,757 on general living costs compared with $27,507 last year.

"It is heaven for Americans who are over here on short-term contracts," confides one U.S. executive in Frankfurt. "The dollars keep coming in, and their value keeps going up. It is a time when Americans abroad can live in a little more luxury than they are used to."

One AT&T staffer in Europe who gets paid partly in dollars and partly in the local currency, admits that he makes "more money when the extra living allowances are added on." But he also adds that his living standard "is about the same as in New Jersey."

These good times however, can't go on forever. J. Frank Gaston, The Conference Board's head of special international studies, points out that "it isn't quite paradise. U.S. companies soon catch on to the fact that they don't have to pay so much in living allowances, so these are often reduced."

Every paradise has its problems.

—P.T.

## The strong dollar should be a heaven-sent opportunity for European firms.

change on the futures markets, Memorex can also exploit the relative strengths of different currencies by transferring product manufacturing to countries that have weaker currencies. "There is a limit," notes Turndal, "to what we can do in this way."

**INVESTED HEAVILY IN PLANT**

So far, Memorex has sunk some $8 million into plant in Europe. The Irish, who offer generous incentives to foreign businesses, have picked up $6 million of the Memorex plant tab, while the Belgians have pulled in the remaining $2 million over the past three years. Such outlays, Turndal points out, look good to the accountants back home. "From a bookkeeping point of view, it looks cheaper to operate in Europe." With a strong dollar, American companies investing abroad get more for their money.

Accounting procedures, however, can cause additional headaches for European subsidiaries that are forced to value all their business in dollars. Take the case of Wang. At the beginning of the year, the company sets its annual sales targets to meet corporate goals. The cost of products that are made in Europe are quoted in dollars. These figures are adjusted monthly to take into account the currency changes. As a result, Wang's profit margins are squeezed every time the dollar rises in international currency markets.

There is another problem. While Wang's sales staff can easily surpass its initial targets in the local currency, the strengthening dollar means it has to work much harder to meet the inflated dollar targets by the end of the year. The sales forces of a number of American subsidiaries are under intense pressure to compensate for the lackluster local currencies.

The strong dollar should be a heaven-sent opportunity for Europe's local dp companies, which are taking a beating in the marketplace, both at home and abroad. The European Commission estimates that its member states, which racked up a $1.7 billion deficit in dp products last year, are losing market share around the world at the rate of 1% a year. European firms, with few exceptions, have not turned the Yankees' dollar dilemma to their advantage.

"Step two: be sure not to press the small, blue button labeled 'reverse' on the back panel."

"Although the dollar is almost 15% stronger against the lira than it was in June 1983, it does not seem to have affected the sale of American dp equipment," observes an official at the U.S. Department of Commerce in Milan. "Italian companies seem willing to pay the price for American dp equipment, no matter how much it costs, because of their interest in modernizing their operations."

"It should be a bonanza for European companies like ICL," says Memorex's Turndal, "but I can't say that they are taking advantage of it." Turndal has, however, encountered pockets of resistance, particularly in Sweden, where Ericsson is very price-competitive.

Data General's Cadogan also feels that ICL has not made the best of the bad dollar situation. "There is no evidence that they are cashing in on a currency advantage. We have been cheaper than ICL on several recent occasions."

ICL itself confirms that the weak pound has not been turned to advantage, at least not in the U.S. "There is no evidence in the latest six-month figures of any export advantage from the currency situation," declares an ICL spokesman.

The truth of the matter is that the American industry is just too robust to let something like a high-flying dollar get in its way. As DEC's McMicking points out, "If you grow the size of your business you are getting margin increases that offset the currency increase."

The steady progress of American and Japanese companies on European soil is already sending cold winds down the corridors of power. A recent report by the National Economic Development Council in Britain speaks of a trade crisis in the dp industry, where the deficit is fast approaching $1.3 billion. To trim that trade deficit, NEDC recommends more training, more cash for R&D and smaller companies, and more public-sector procurement of British products.

American companies' worries about overseas profits are nothing compared to the fears European firms harbor about their long-term survival. And, in fact, American dp companies seem to be coping quite well in the marketplace, despite the strong dollar—a situation they will just have to learn to live with. Indeed, the latest economic forecasts show little change in the dollar's status between now and the end of the decade.

The American eagle has definitely landed in Europe. Determined to cope with the soaring dollar, the U.S. dp industry will continue feathering its comfortable European nest. ◉

CARTOON BY THOMAS CHENEY